CAPITAL GAINS TAX EXEMPTION ON INVESTMENT IN STARTUPS

Startup Series #6

In order to boost investment in start-ups and to provide tax relief to an individual or HUF who have sold residential property, the Central Government through Finance Act 2016 had amended the provisions under Section 54GB so as to provide exemption on long term capital gains from transfer of residential property, if such capital gains are invested in subscription of shares of a startup company subject to certain conditions.

*In continuation to our **'Startup Series'**, let us look at the capital gains exemption available to investors of startups and the conditions to be satisfied in **#6** of the series.*

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Provisions applicable to start-ups

Section 54GB of the Income Tax Act 1961 (‘IT Act’) provides exemption from tax on long capital gains arising from transfer of a residential property owned by an individual or HUF if proceeds from such transfer are utilized for subscription in the equity shares of **eligible company** and conditions provided under the aforesaid section are satisfied.

Eligible company means a company which **fulfils all** the following conditions:

- The said company is **incorporated between** the start of the previous year in which **capital gain arises** and the **due date of furnishing** income tax return for such previous year as applicable to the assessee.
- It is an “eligible startup” engaged in an “eligible business” *(refer definition in our alert #2).*
- Individual or HUF investor has invested **more than 25%** of share capital or voting rights in the said company.

The provisions of this section shall not apply for transfer of residential property after **31st March 2022.**

Conditions to be satisfied for claiming exemption (1/2)

- Net consideration / proceeds from transfer of a residential property **are utilized by individual / HUF** towards subscription in equity shares of an eligible startup **before the due date of furnishing income tax return.**

- The eligible startup must utilize the amount invested to purchase new assets **within 1 year** from the date of subscription in equity shares.

- In case the consideration is **not utilized** by the eligible startup for purchase of new asset within the due date of furnishing of income tax return applicable to individual or HUF, the same shall be deposited in Capital Gains Accounts Scheme (‘Scheme’) before the said due date. Further, the income tax return furnished by individual or HUF investor shall be **accompanied by proof** of the said deposit being made.

- The aforesaid deposit along with actual amount utilized for purchase of new asset shall be **construed to be cost of new asset**.

- The equity shares of the startup company held by the assessee and the new asset acquired by the startup company shall not be transferred **within a period of 5 years** from the date of its acquisition. In case the new asset is ‘computer or computer software’, it shall not be transferred **within a period of 3 years** by technology driven Startup as certified by Inter-Ministerial Board of Certification (‘IMBC’).

Conditions to be satisfied for claiming exemption (2/2)

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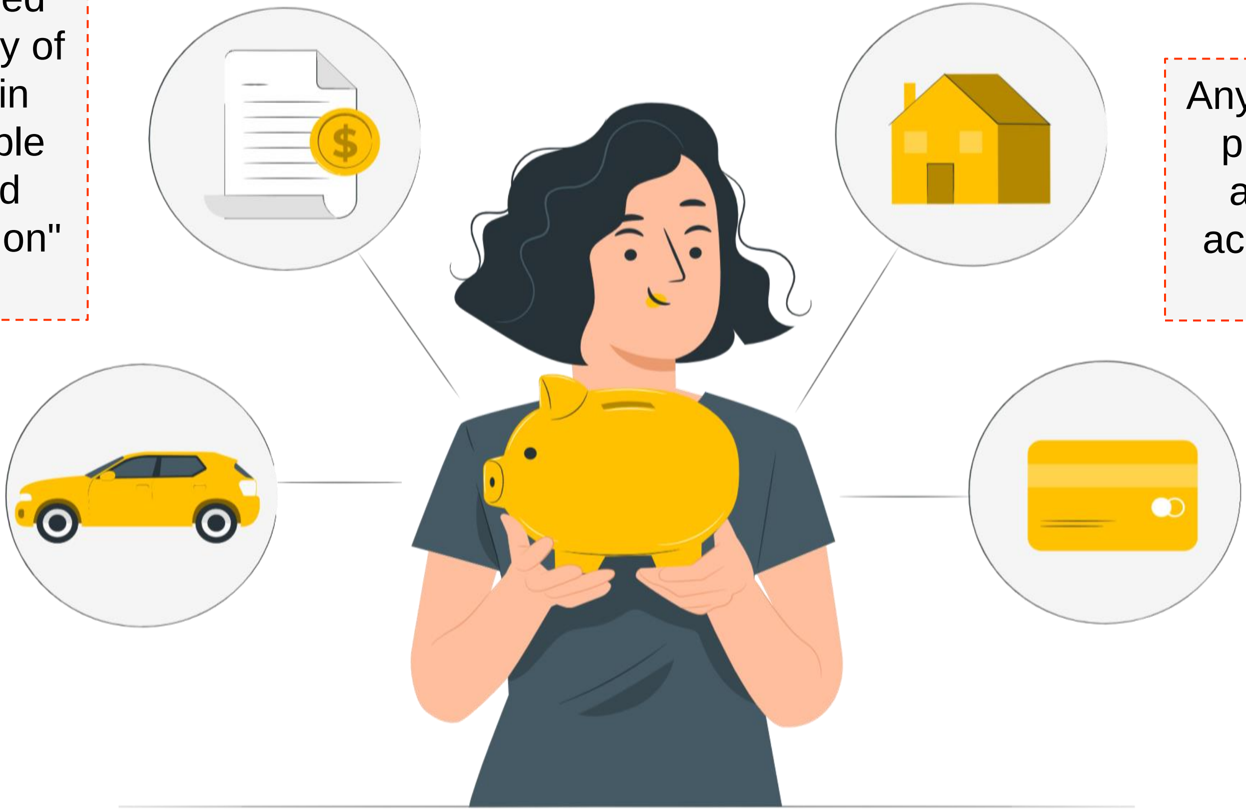
New asset refers to new plant and machinery (‘P&M’), but does not include the following:

Any P&M, which before its installation was used either within or outside India by any other person.

Any P&M, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing income chargeable under the head "Profits and gains of business or profession" of any previous year.

Any P&M installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house.



Any vehicle.

Any office appliances including computers or computer software.

Quantum of exemption u/s 54GB

Following is the illustration for computing quantum of exemption available from capital gains income under Section 54GB:

Case 1 – If net consideration from transfer of a residential property > Cost of new asset:

The capital gains shall be proportionately exempted based on the cost of new asset to the net consideration as computed in the below table.

Case 2 – If net consideration from transfer of a residential property < Cost of new asset:

The capital gains shall be fully exempted from income tax as computed in the below table

Particulars	Reference	Amount (Rs. in lakhs)	
		Case 1	Case 2
Net consideration	(A)	800	800
Less: Cost of acquisition	(B)	(500)	(500)
Long term capital gain	(C) = (B)-(A)	300	300
Cost of new asset	(D)	500	800
Exemption u/s 54GB	(E) = (C) *(D)/(A)	187.5	300
Capital gain chargeable to tax	(C)-(E)	112.5	-

Consequences of default

<table>
<tr><th>Contravention</th><th>Consequence</th></tr>
<tr><td>In case the deposited amount is not utilised (wholly or partly) by the eligible company for purchase of new asset within the period of 1 year</td><td>Difference between the following shall be taxable as capital gains in the hands of individual or HUF investor in the previous year in which the period of 1 year for acquiring new asset expires:

1. The exemption allowed under Section 54GB of IT Act, and
2. The exemption that should have actually been allowed based on the actual amount utilized for purchase of new asset within a period of 1 year.</td></tr>
<tr><td>The eligible company transfers the new asset within a period of 5 years / 3 years (as the case may be) from the date of its acquisition.</td><td rowspan="2">The exemption earlier allowed under section 54GB of IT Act shall be deemed to be income under the head capital gains of the previous year in which the new assets or equity shares are transferred in the hands of individual or HUF investor.</td></tr>
<tr><td>The individual or HUF transfers equity shares in the eligible company within a period of 5 years from date of its acquisition.</td></tr>
</table>

Stay tuned for more updates on Startups!

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In case you have missed the previous alerts, click on the hyperlinks to refer the same.

- #1 [Startup recognition]
- #2 [Tax holiday benefit]
- #3 [Angel Tax Exemption]
- #4 [Taxability of ESOPs]
- #5 [Carry forward & set off of losses by startups]
- #6 **Capital gains exemption on investment in startups**
- #7 **Exchange control provisions**
- #8 **Labor law relaxations**
- #9 **Startup India Seed Fund**
- #10 **Other regulatory provisions / benefits**

THANK YOU

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